

How To Correctly Identify The Trend (part 1 of a series)

If there is one piece of the trading puzzle that remains a bit unclear for traders it is that of the 'trend'. Depending on whom you speak to, each will have a different answer. Regardless, of their answer however, it is critical that you arrive at the correct answer in the context of how that person trades. Failure to correctly identify the trend will greatly reduce the odds of success.

The first place to start is identifying which time frame you plan to make your trade off of. For me, I only have three choices, 60-minute, 240-minute or the daily chart, as these are the only three time frames I follow for trade set-ups. The vast majority of the trades are based on the 60-minute chart however. So, for the time being, let's keep it simple, I will not factor in the other time frames as it can get a bit confusing.

What is the trend on the following chart?



In all fairness, it is a bit of a trick question. The answer, based on my approach, is that there is simply not enough information to make that call. Sure, the last several bars have been moving up, but overall prices are still trending lower.

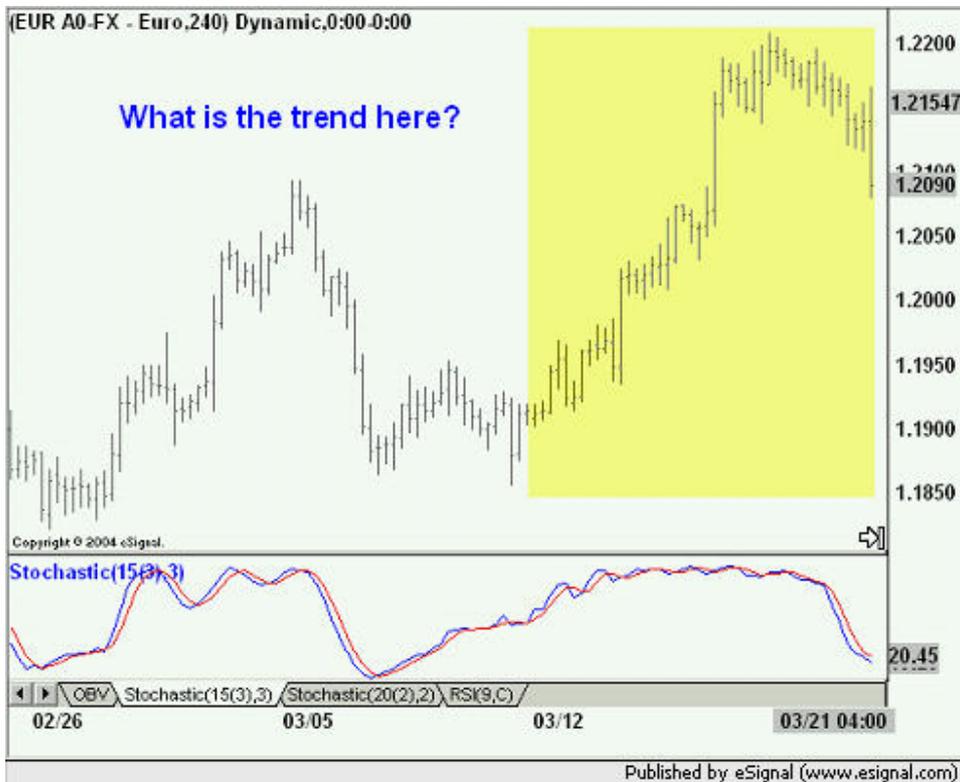
Let's add one more piece of information to the chart.



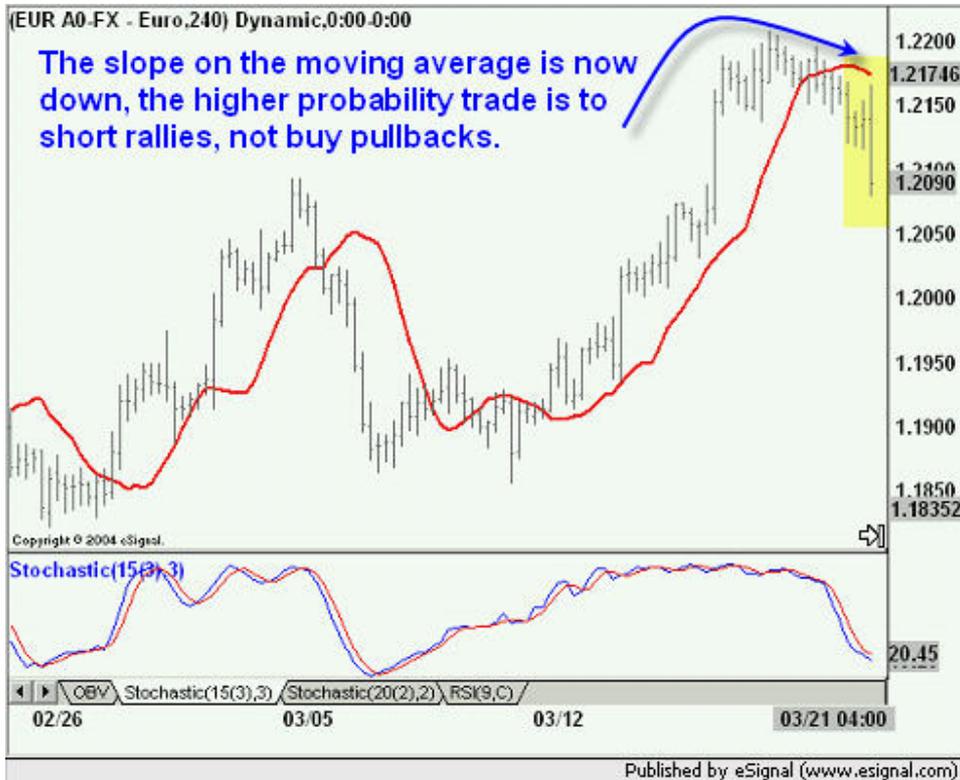
By adding a moving average, one can much better analyze the 'current' trend. Remember, I am not terribly interested about what happened several hours ago, but I am interested in what has happened in the last 4-6 hours.

Without the moving average, it is nearly impossible to correctly identify what the current trend is.

Let's look at another example.



I suspect there were some readers who said; “The trend is up, I will look to buy into this pull-back.” But again, there is simply not enough information to draw that conclusion presently. Let’s add in the moving average.



If you did not correctly identify the trend, many will succumb to buying the pullback into support, or in this case fib support – this losing trade could easily have been avoided if you correctly identified the trend.

Needless to say, this trade would have flamed out badly.



Later this week I will go into more detail about correct trend definition as well as factoring in other time frames in order to refine your definition of the trend.

As always, feel free to send me your comments and questions.

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